

ST 01-0043-GIL 02/22/2001 TELECOMMUNICATIONS EXCISE TAX

Generally, persons who provide subscribers access to the Internet and who do not, as part of that service, charge customers for the line or other transmission charges which are used to obtain access to the Internet, are not considered to be telecommunications retailers from these activities. See 86 Ill. Adm. Code 495.110. (This is a GIL.)

February 22, 2001

Dear Xxxxx:

This letter is in response to your letter dated November 20, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

I'm writing to respectfully request a ruling regarding the application of Illinois State taxes to the following business activities outlined below:

**FACTS**

Corporation A is a virtual Internet Service Provider (ISP). What this means is that the Corporation performs all services required to enable a 'client organization' to offer a totally branded Internet access to its members (consumer end-users). The 'client organization' advertises this Internet access service offering to their members (consumer end-users). This service carries the name selected by the client organization (usually something similar to the organization's name). As soon as an end-user requests Internet access service, Corporation A takes over. We do all the work behind the scenes, including setting up the end-user, assigning user ID, password, email maintenance, storage, customer service, technical support, and billing. The consumer end-user is charged a set monthly fee that is determined by the 'client organization' (say \$15.95). For providing all services relating to Internet access, Corporation A charges the 'client organization' a fixed monthly per end-user fee (say \$11.50). Corporation A charges the end-user's credit card the \$15.95, under the name of the client organization's ISP name. Corporation A handle credit card processing and credit authorization. A bank account is set up for these charges, which is solely controlled by Corporation A. Once a month, the Corporation wires funds out of the account to the 'client organization' for their net share of the receipts (\$15.95 - \$11.50 for each end-user per month). The 'client organization' does not involve in billing and/or collections. The business model can be summarized by the following example:

AAA opens up a new line of business - selling Internet access services. AAA advertises to the public that AAA is now offering Internet access services. As soon as an end-user requests Internet access services from AAA. Corporation A takes over. Corporation A

does all the work including set up the end-user, assigning user ID, password, email maintenance, customer service, technical support, and billing. As far as end-user concerns, AAA is his/her Internet service provider. Corporation A is unknown by the end-user. AAA determines a monthly fee that it wants to charge the end-user (say \$15.95/month). Corporation A charges AAA a fixed monthly fee per end-user (say \$11.95/month). As soon as Corporation A set up the end-user account, Corporation A charges the end-user's credit card \$15.95 under the name of AAA. Corporation A handles credit card processing and credit authorization. AAA does not bill its end users.

Every time end-users want to get Internet access, they dial into a local phone number (i.e. if the end-user computer sets up in Chicago, he/she needs to dial a Chicago phone number to get access). This local phone number is normally referred to as a local 'POP', or point of presence. The Corporation use CCC and XYZ for these POPs'. Corporation A is billed by CCC and XYZ for the monthly usage. Once the end-users dial the local phone number, it will be routed to our server that is located outside of Illinois. The Corporation do not have an office or any employees in Illinois.

Corporation A and BBB are affiliated companies. They both are owned by the same corporation. BBB is a provider of DSL (Digital Subscriber Line) services. BBB is not a dial-up Internet Service Provider. BBB is classified as a telecommunication company, a Competitive Local Exchange Carrier(CLEC). DSL uses existing copper telephone lines to transmit very high-speed data communications services to ISPs. ISPs purchase DSL services in order to provide high-speed Internet access to their business and then bundle DSL with other internet access service (email, web hosting, etc.) and sell it as a 'internet access package' to its consumer end-users. Corporation A will soon start purchasing DSL services from BBB, and then combine the DSL service with Internet access into one 'internet access package' and sell it to 'client organization' who then will sell the DSL services to its consumer end-users.

## **RULING REQUEST**

I respectfully request the following legal rulings:

1. Whether, under the facts described above, Corporation A has nexus within Illinois
2. Whether the entire monthly internet access charges (basic internet access plus DSL charges) subject to sales tax? Or the charges are not taxable due to the Internet Freedom Act? Is the DSL charge itself subject to sales tax?
3. Whether Corporation A is required to collect sales tax from its 'client organization's end-users.
4. Whether the client organizations are considered agents/sales representatives of Corporation A. Thus, the 'client organization' does not require to file, collect and remit sales tax
5. Whether BBB should charge Corporation A sales tax on the DSL services? If Corporation A provides a resale certificate to BBB, is BBB allowed not to charge sales tax
6. Whether Corporation A subject to Illinois' telecommunications taxes

I appreciate your consideration of the matters described herein and look forward to your response eagerly. Please contact me if you have any questions regarding this request or need additional information.

## NEXUS

Taxpayers may use the following guidelines concerning the different types of retailers in order to determine whether a business should remit and collect Illinois Retailers' Occupation Tax and Use Tax.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201 subsection (i) (see enclosed). This type of retailer is required to register with the State as an Illinois Use Tax collector (see 86 Ill. Adm. Code 150.801 enclosed). The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailers' Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. It is important to note that under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative and it is immaterial for tax purposes that the representative's presence is temporary.

## SALES TAX

The Illinois Retailers' Occupation Tax (commonly known as sales tax) is imposed upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. The tax is measured by the seller's gross receipts from such sales made in the course of such business. See the enclosed copy of 86 Ill. Adm. Code 130.101. Transactions which do not involve the sale of tangible personal property at retail are not subject to the Retailers' Occupation Tax. In addition, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See the enclosed copy of 86 Ill. Adm. Code 150.101.

## TELECOMMUNICATIONS

The Telecommunications Excise Tax Act imposes a tax upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. Please see the enclosed copy of 86 Ill. Adm. Code Part 495. This tax must be collected from person by retailers maintaining a place of business in Illinois and is then remitted directly to the Department by such retailers. See Section 495.110.

Section 2(c) of the Act defines "telecommunications," and states that this term does not include "value added services in which computer processing applications are used to act on the form, content, code and protocol of the information for purposes other than transmission." Section (2)(a)(3) of the Act states that the term, "gross charge," which forms the basis for the tax, does not include "charges for leased time on equipment or charges for the storage of data or information for subsequent retrieval or the processing of data or information intended to change its form or content."

Generally, persons that provide subscribers access to the Internet and who do not, as part of that service, charge customers for the line or other transmission charges which are used to obtain access to the Internet, are not considered to be telecommunications retailers. See 86 Ill. Adm. Code 495.100(d). It is our general understanding that most Internet access providers do not, as part of their billing, charge customers for such line charges, but instead, pay to their telecommunications providers all transmission costs that they incur in providing the service. Generally, the customers pay to their providers all transmission costs that they incur while using the service. The single monthly fee charged by such retailers, which often represents a flat charge for a package of items including Internet access, E-mail, and electronic newsletters would generally not be subject to the Telecommunications Excise Tax.

However, please note that persons providing customers with Internet access, but who also provide customers the use of 1-800 service, and separately assess customers with per minute charges for the use of such 1-800 numbers, are considered to be telecommunications retailers. Such retailers will incur Telecommunications Excise Tax on charges made for such 1-800 services. If, however, such Internet service providers do not separately assess customers with per minute charges, but pay their own providers for all transmission costs for the 1-800 service, they would not be considered to be telecommunications retailers. Generally, Digital Subscriber Line (DSL) service is telecommunications subject to Telecommunications Excise Tax.

If Internet access service providers provide both transmission and data processing services, the charges for each must be disaggregated and separately identified. See 86 Ill. Adm. Code 495.100(c), enclosed. The statute does not require disaggregation on the customers' invoice, however. Therefore, it is the Department's position that so long as the non-telecommunications charges are disaggregated from the telecommunications charges in the retailers' books and records, for audit purposes, such disaggregation need not be shown on the customers' invoice. If the non-telecommunications charges are not disaggregated from the telecommunications charges, the full amount will be subject to Telecommunications Excise Tax. If none of the charges billed are for telecommunications, then none of the charges would be subject to tax.

Retailers of telecommunications who are reselling telecommunications are required to register with the Department, file returns, and remit Telecommunications Excise Tax directly to the Department. Purchases by telecommunications retailer from local and long distance carriers for line time may be purchased without incurring tax by providing these suppliers with resale certificates.

As we understand it, a DSL provider sells DSL services to an Internet Service Provider (ISP). The ISP resells the DSL services, bundled with Internet access services, to a client organization ISP. The client organization ISP also resells the bundled services to end-users. In the scenario you have described, it appears that the DSL service is resold several times between purchasers and that each ISP separately charges for the DSL service. This being the case, the client organization ISPs appear to be selling the DSL services at retail. (The DSL provider and the ISP appear to be selling the DSL services for resale.) Therefore, assuming the client organization ISPs have nexus in Illinois, the client organization ISPs are subject to Telecommunications Excise Tax on the DSL service charges. If the client organizations disaggregate the DSL service charges from the Internet access charges, only the DSL service charges will be subject to Telecommunications Excise Tax. If the DSL charges are not disaggregated from the Internet access charges, the whole amount will be subject to Telecommunications Excise Tax.

If, however, either one of the ISPs pays its supplier for the DSL services and does not separately assess its customers for the DSL services, it would not be considered a reseller of the DSL services, but rather, a user of such services. In these cases, no Telecommunications Excise Tax will be incurred on the ISP's sale to its customers. For example, BBB could collect Telecommunications Excise Tax from the ISP. Provided the ISP did not separately assess the client organization ISP for the DSL charges, the ISP would be considered an end user of the DSL services. It would not incur Telecommunications Excise Tax on its sales of Internet access to the client organization ISP, and the client organization ISP would not incur any tax on sales to its customers under this scenario.

Similarly, if BBB resold the DSL service to the ISP (e.g., the ISP provided BBB with a resale certificate), the ISP could then be considered a telecommunications provider to the client organization ISP. If the client organization ISP paid the ISP Telecommunications Excise Tax on the DSL services, it would not incur any Telecommunications Excise Tax on its sales of Internet access, provided that it did not separately assess its customers for the DSL services. In this case, the client organization ISP would be an end user of the DSL services.

Charges for Internet access service are not subject to Illinois' Telecommunications Excise Tax as long as they are disaggregated from the telecommunication charges, if any, associated with the transmission of data. Charges for the transmission of data are subject to the Telecommunications Excise Tax. Since DSL is a telecommunications service, charges for DSL are subject to Illinois' Telecommunications Excise Tax. The Internet Tax Freedom Act does not affect the imposition of the Telecommunications Excise Tax because it is not a tax on Internet access.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Martha P. Mote

Associate Counsel

MPM:msk  
Enc.